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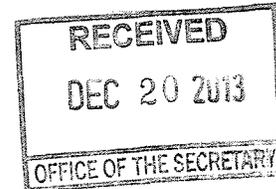
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15263

In the Matter of

ZPR INVESTMENT MANAGEMENT,
INC. AND MAX E. ZAVANELLI,

Respondents.



DIVISION OF ENFORCEMENT'S POST-HEARING REPLY BRIEF

Amie Riggle Berlin, Esq.
Senior Trial Counsel

DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
801 Brickell Avenue, Suite 1800
Miami, FL 33131
Direct: (305) 982-6322
Phone: (305) 982-6300
Fax: (305) 536-4154
Email: berlina@sec.gov

I. INTRODUCTION

Respondents ZPR Investment Management, Inc. (“ZPR”) and recidivist Max E. Zavanelli’s¹ Post-Hearing Brief ignores the applicable law and the evidence presented at the Final Hearing in this matter. The evidence demonstrated that the Respondents made false statements about ZPR’s compliance with the Global Investment Performance Standards (“GIPS”), ZPR having been audited, and the Securities and Exchange Commission’s pending investigation of ZPR as part of a conscious effort to lure new investors.

The Respondents now admit that all of the advertisements at issue claimed GIPS compliance while failing to comply with GIPS by omitting the performance returns information GIPS requires. They admit there was a pending Commission investigation against ZPR when they generated and distributed false Morningstar Reports telling potential investors there was no investigation. Nonetheless, they argue that the conduct at issue, which spanned more than two years, reflects nothing more than innocent mistakes. The evidence shows to the contrary. It shows a conscious effort, made with full knowledge of the GIPS advertisements requirements and the pending Commission investigation, to conceal the truth and solicit new investors by whatever means were necessary. This pattern of conduct demonstrates scienter.

As ZPR’s vice president Ted Bauchle testified, from 2006 until early 2008, ZPR published advertisements using a template its GIPS verifier provided which included period-to-date performance returns. However, ZPR experienced negative performance returns in March 2008, and so commencing with its next advertisement – the October 2008 *Smart Money* Magazine advertisement at issue – ZPR changed its advertisements to omit the period-to-date performance

¹ DX 12, DX 97

returns GIPS requires. As Bauchle admitted, ZPR changed the advertisement to omit this information because it would have revealed negative performance returns, which “would not look good.”² However, the Respondents continued to claim GIPS compliance in the advertisements because Zavanelli knew that claiming GIPS-compliance was necessary for obtaining institutional investors. And so he made false claims of GIPS compliance, touted the firms’ positive historical performance returns, and omitted the more recent negative returns GIPS required. Thus began the Respondents’ false advertisements in October 2008, which continued in magazine and newsletter advertisements until at least May 2011.

ZPR was in dire financial straits in 2008, and in mid- and late-2009, Zavanelli was loaning the firm money just to keep it afloat. The Respondents continued to publish false and misleading advertisements because they needed to lure new investors. Zavanelli continued making the same false claims of GIPS compliance while omitting the GIPS-required performance returns even after Bauchle told him the advertisements, even after ZPR’s GIPS verifier told him the advertisements were not GIPS-compliant, and even after the Commission told him the same thing.

After the Respondents learned of the Commission’s pending investigation against ZPR in August 2010, they made false statements in their advertisements about that as well. In October 2010 and April 2011, the Respondents published Morningstar Reports for the periods September 2010 and March 2011 in which they made false statements that there was no pending Commission investigation. These same advertisements also included the false claims of GIPS compliance and falsely stated ZPR was audited. As with the magazine and newspaper

² Tr. 187:17-189:22.

advertisements, ZPR knew these statements were false but made them anyway, with reckless disregard for the truth.

Contrary to the Respondents' assertions, this pattern of deceptive conduct clearly demonstrates scienter.

The Respondents' arguments concerning materiality ignore Zavanelli's admission at the Final Hearing that the claim of GIPS compliance and verification is important to institutional investors in choosing an investment adviser. The undisputed evidence showed institutional investors do not consider firms that do not claim GIPS compliance verification. Clearly then, an institutional investor would have wanted to know that ZPR's GIPS compliance claims were false. Indeed, the Respondents concealed their non-GIPS compliant advertisements from ZPR's GIPS verifier so they could continue to obtain GIPS compliance verification that was necessary to lure investors. Also misplaced is the Respondents' argument that the false claims concerning the Commission's investigation are not material. Contrary to the Respondents' assertions, a reasonable investor would have wanted to know that ZPR's claim that there was no pending Commission investigation was indeed false.

The Division of Enforcement has demonstrated ZPR and Zavanelli violated Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act or, in the alternative as to Zavanelli, that he aided, abetted and caused ZPR's violations of these provisions of the Advisers Act. And the Respondents' arguments do not support a different conclusion.

As set forth more fully in the Division's Post-Hearing Brief, the evidence demonstrates the Respondents have no respect for the law, no respect for ethical standards, and no respect for the truth. The Law Judge should impose a permanent bar against Zavanelli, censure ZPR, enter cease-

and-desist Orders against ZPR and Zavanelli, and impose a one-time, second-tier penalty against ZPR, and second-tier penalties against Zavanelli for each of violation at issue in this case.

II. RESPONDENTS' ARGUMENT THAT THE ADVERTISEMENTS LACKED ANY MISREPRESENTATION OR OMISSION IS BELIED BY THEIR OWN ADMISSIONS

A. THE 2008 AND 2011 MAGAZINE ADVERTISEMENTS

At the Final Hearing, Zavanelli admitted ZPR's October, November, and December 2008 advertisements and February, March, and May 2011 advertisements contained the misrepresentations and omissions set forth in the OIP.³ As to the 2008 advertisements,⁴ Zavanelli admitted the three 2008 advertisements touted ZPR's compliance with GIPS and yet:

- Disclosed only ZPR's historic performance returns, which showed positive performance returns *overperforming* ZPR's benchmark index;
- Failed to comply with GIPS by omitting the period-to-date performance returns GIPS required;⁵ and
- Had ZPR disclosed the period-to-date returns GIPS requires, this information would have revealed that ZPR was trading for negative returns and *underperforming* its benchmark index.⁶

The Respondents' argument that these advertisements do not contain misrepresentations and omissions ignores the well-established principle that when ZPR stated these advertisements were GIPS compliant, it became obligated to speak fully about any material facts on that subject

³ Tr. 1662:6-1686:11.

⁴ DX 21 at 5-7.

⁵ Tr. 1662:6-1686:11; DX 5-7; DX 21 at 34 Guideline 5 (requiring disclosure of period-to-date performance returns in advertisements claiming GIPS compliance). GIPS compliance is voluntary. However, once a firm claims GIPS compliance, compliance with GIPS is *mandatory*. Tr 925:2-15; DX 25 (2005 GIPS) at p.34 ("All advertisements that include a claim of compliance with the GIPS Advertising Guidelines MUST include the following...."). GIPS Advertising Guideline 5 required that advertisements claiming GIPS compliance present, among other things

⁶ DX 21 at 5-7.

the absence of which would make the advertisements misleading.⁷ By not disclosing the GIPS-required period-to-date returns in these advertisements, ZPR was able to conceal the fact that it was underperforming the market. This is an omission and the Court should find this element met as to the 2008 advertisements.

The advertisements also contain misrepresentations about ZPR's GIPS compliance. ZPR claimed GIPS compliance in the advertisements, but in truth these advertisements failed to comply with at least 4 of the 10 GIPS advertising requirements.⁸ As the evidence showed at the Final Hearing, ZPR:

- Omitted disclosures required in GIPS Advertising Guideline 2, which requires a disclosure of “[h]ow an interested party can obtain a presentation that complies with the REQUIREMENTS of GIPS standards and/or a list and description of all FIRM COMPOSITES;”⁹
- Omitted the performance return information required in Guideline 5, which required the presentation of “Period-to-date COMPOSITE performance results in addition to either: (a) 1-, 3-, and 5-year cumulative annualized COMPOSITE returns... or (b) 5 years of annual COMPOSITE returns;”
- Omitted the performance return information required in Guideline 8, which requires the advertisements to identify the currency of the performance returns shown; and
- Omitted the disclosures required in Guideline 10, which required that “[w]hen presenting noncompliant performance information for periods prior to 1 January 2000 in an advertisement, FIRMS MUST disclose the period(s) and which specific information is not compliant as well as provide the reason(s) the information is not in compliance with the GIPS standards.”¹⁰ Zavanelli admitted at the Final Hearing that the 2008 advertisements presented noncompliant performance information for the

⁷ DX 1.

⁸ Pursuant to GIPS, a firm claiming GIPS compliance must follow *all* the GIPS Advertising Guidelines.

⁹ DX 25 at p.34.

¹⁰ DX 25 at p.34.

periods prior to January 1, 2000 and yet failed to include the information Guideline 10 requires.¹¹

Thus the Law Judge should find the 2008 advertisements contained omissions and misrepresentations.

As for the 2011 advertisements, ZPR claimed GIPS compliance in the advertisements¹² and was therefore required to comply with the GIPS Advertising Guidelines.¹³ However, as Zavanelli admitted, ZPR failed to so comply in these very advertisements. Specifically, ZPR:

- Omitted disclosures required in GIPS Advertising Guideline 2, which requires a disclosure of “[h]ow an interested party can obtain a presentation that complies with the REQUIREMENTS of GIPS standards and/or a list and description of all FIRM COMPOSITES;”¹⁴
- Omitted the 3 and 5-year annualized performance returns or 5 years of annual returns, as well as the period-to-date returns GIPS Advertising Guideline 5 required;¹⁵
- Omitted the performance return information required in Guideline 8, which requires the advertisements to identify the currency of the performance returns shown; and
- Omitted the disclosures required in Guideline 10, which required that “[w]hen presenting noncompliant performance information for periods prior to 1 January 2000 in an advertisement, FIRMS MUST disclose the period(s) and which specific information is not compliant as well as provide the reason(s) the information is not in compliance with the GIPS standards.”¹⁶ Zavanelli admitted at the Final Hearing that the 2008 advertisements presented noncompliant performance information for the periods prior to January 1, 2000 and yet failed to include the information Guideline 10 requires.

¹¹ DX 117, 118, Tr. 869:3-875:1.

¹² RX 15, 17, 19.

¹³ DX 26 (2010 GIPS) at p.30 (“All advertisements that include a claim of compliance with the GIPS standards by following the GIPS Advertising Guidelines and that present performance MUST also disclose the following information....”).

¹⁴ DX 25 at p.34.

¹⁵ DX 25 at p.30, Guideline 5; Tr. 1662:6-1686:11; RX 15, 17, 19.

¹⁶ DX 25 at p.34.

Accordingly, the Law Judge should find the 2011 advertisements made misrepresentations about ZPR's GIPS compliance.

Since the Respondents can no longer deny these misrepresentations and omissions, they resort to making three arguments, none of which has merit. First, the Respondents argue the advertisements told the truth about *other* matters not at issue in this case – namely, that they did not misrepresent their performance return figures.¹⁷ However, this is not the misrepresentation at issue in this matter.¹⁸

Second, the Respondents argue the GIPS-required information they omitted in the advertisements was available to potential investors elsewhere and therefore the advertisements did not contain any misrepresentations or omissions.¹⁹ This argument does not affect the conclusion that the advertisements contained misrepresentations and omissions. As discussed above, once the Respondents began speaking on the subject of GIPS compliance in these advertisements, they were required to disclose any information the absence of which would make the advertisements misleading. Without the GIPS-required information, all six advertisements claimed GIPS compliance while simultaneously violating it. GIPS requires that the required information must appear *in the advertisements*²⁰ and, as Zavanelli admitted, ZPR did not include it.²¹ Thus, even if ZPR disclosed the GIPS-required information elsewhere, this did not comply with GIPS. In

¹⁷ Respondents' post hearing brief at 43-44.

¹⁸ DX 1.

¹⁹ Respondents' post hearing brief at 43-44.

²⁰ DX 25 at 34; DX 26 at 30; Tr. 955:13-956:4.

²¹ DX 25 at 34; DX 26 at 30. Nor did ZPR distribute a fully compliant GIPS presentation that spanned the same period as the performance returns presented in the advertisements. This is because no such presentation existed. Bauchle testified that they only prepared one fully compliant GIPS presentation, at the end of each year and did not prepare them for each advertisement period.

addition, the omission of the GIPS-required information enabled the Respondent to present ZPR's performance returns in the advertisements as *over*performing the market, while the inclusion of the required information would have revealed the truth – that ZPR was *under*performing and trading for negative performance returns.

Third, the Respondents argue these advertisements do not contain misrepresentations and omissions because the advertisements failed to lure investors. This is wrong. A misrepresentation or omission is still just that, regardless of how successful the Respondents were in luring investors. In addition, unlike a private plaintiff, the Division need not demonstrate investor reliance or damages.²² Further, the evidence presented at the Final Hearing was that ZPR did obtain two investors from the advertisements.²³

Based on the foregoing, the Law Judge should find the 2008 and 2011 advertisements contained misrepresentations and omissions.

B. THE 2009 NEWSLETTERS

The Respondents' argument that the 2009 Newsletters²⁴ lacked any misrepresentations or omissions are similarly unavailing. The Respondents admit the newsletters are advertisements but argue that aside from GIPS claims, the newsletters contained accurate information. According to the Respondents, "absent the claim of GIPS compliance in the newsletters, there was nothing

²² Unlike private litigants, the SEC need not prove the additional elements of reliance or loss causation. *See SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir.1993) ("The SEC need not prove reliance in its action for injunctive relief on the basis of violations of section 10(b) and Rule 10b-5."); *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir.1985) ("Unlike private litigants seeking damages, the Commission is not required to prove that any investor actually relied on the misrepresentations or that the misrepresentations caused any investor to lose money.").

²³ DX 119.

²⁴ DX 44; DX 89.

inaccurate or misleading in these advertisements.”²⁵ This argument ignores the fact that the newsletters contained statements concerning ZPR’s GIPS compliance,²⁶ and therefore compliance with the GIPS Advertising Guidelines was mandatory.²⁷ It is undisputed that the newsletters failed to comply with them. Thus, the statements in the 2009 newsletters concerning GIPS compliance are misrepresentations for the same reasons set forth above concerning the 2008 and 2011 advertisements.

C. THE 2010 AND 2011 MORNINGSTAR REPORTS

The Respondents’ arguments that the Morningstar Reports are not advertisements are without merit. The Respondents contend these reports are not advertisements because: (1) the information ZPR provided was voluntary; (2) ZPR did not pay Morningstar for publishing the reports; (3) only potential institutional investors (as opposed to retail investors) with Morningstar subscriptions could view the reports.²⁸ Even if true, none of these facts is relevant to determining whether a publication is an advertisement under the Advisers Act. Nor can the Respondents identify any legal support for their curious arguments.

Pursuant to Rule 206(4)-1(b) of the Act, an “advertisement” is defined as follows:

For the purposes of this section the term *advertisement* shall include *any* notice, circular, letter or other *written communication addressed to more than one person*, or any notice *or other announcement in any publication* or by radio or television, *which offers* (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to

²⁵ Respondents’ post hearing brief at p.44.

²⁶ DX 44; DX 89.

²⁷ DX 25 at p.34.

²⁸ Respondents’ post hearing brief at 44 (emphasis added).

buy or sell any security, or which security to buy or sell, or (3) *any other investment advisory service with regard to securities.*²⁹

This definition is bereft of mention of the voluntary nature of the advertisement, whether a fee is paid for the advertisement, or whether the potential investors must be institutional versus retail investors. Thus, the Respondents' arguments are without merit.

Additionally, the Commission has previously found that information provided to and distributed by database services for the purpose of soliciting prospective investors constitutes an advertisement under Rule 206(4)-1(b) and that providing false information for distribution by the database services violates Section 206(4) and Rule 206(4)-1(a)(5) of the Advisers Act.³⁰

Further, ZPR submitted its data to the Morningstar database for purposes of soliciting potential investors.³¹ The Morningstar database is comprised of investment adviser information and is a tool Morningstar sells to institutional investors to allow them to research potential investment advisors to manage their money.³² And critically, ZPR emailed their Morningstar reports to potential investors.³³ Thus, the Morningstar Reports clearly meet the definition of an advertisement.

The Respondents' arguments that the Morningstar Reports lacked any misrepresentations are wrong. The Respondents' argument that some parts of the Report were accurate, including the

²⁹ 17 CFR 275.206(4)-1(b).

³⁰ See *In the Matter of Groh Asset Management, Inc., et. al.*, Admin. Proc. No. 3-11691, Advisers Act Rel. No. 2308, 2004 WL 2192394 (Sept. 30, 2004) (finding that an investment adviser willfully violated the antifraud provisions of the Act by disseminating false and misleading information to potential investors through third party ranking publications and databases).

³¹ Tr. 248:25-249:25.

³² Tr. 249:13-20

³³DX 153, DX 154

five-star rating, has no relevance to the misrepresentations at issue in this matter. The Respondents' argument that the false statements in the Reports were the results of mistakes has no relevance to the Law Judge's inquiry as to whether or not the Reports contained misrepresentations. Whether intentional, reckless, or negligent, a misrepresentation is a misrepresentation.³⁴

The Respondents' argument that the Division "is required to show that the misrepresentation or omission was communicated to someone and that some harm or loss resulted"³⁵ reflects a gross misunderstanding of the federal securities laws. Respondents do not cite a single relevant case in support of this argument. Nor can they. It is well-established that unlike a private litigant, the Commission need not demonstrate investor losses.³⁶

The undisputed evidence showed the September 2010 and March 2011 Reports told potential investors there was no "pending Commission investigation,"³⁷ and that this was false. There was a pending Commission investigation of ZPR, and ZPR, through Zavanelli, was fully aware of it.³⁸ Thus, these Reports contained misrepresentations and this element is met.

Further, the September 2010 Report contained the additional misrepresentation that ZPR had been "audited for GIPS compliance for the period December 31, 2000 to the present" by Ashland.³⁹ The Respondents claim this was not a misrepresentation because they once again made

³⁴ The elements of scienter and negligence are discussed *infra*, in Section III.

³⁵ Respondents' post hearing brief at 45.

³⁶ *Rana Research, Inc.*, 8 F.3d at 1364; *Blavin*, 760 F.2d at 711.

³⁷ DX 10 and 11.

³⁸ Tr. 437:24-438:4 and 773:13-16; DX 89, 92, and 157, .

³⁹ DX 10; Tr. 255:21-256:2.

a mistake. Whether or not it was a mistake is not relevant to the inquiry as to whether the statement constituted a misrepresentation. The relevant evidence clearly showed the statement in the Report was false. Ashland had resigned as ZPR's GIPS verification firm in July 2010 and its last report attesting to ZPR's compliance with GIPS, covered the period ending December 31, 2009.⁴⁰ In October 2010, ZPR did not even have a GIPS verifier because Ashland resigned effective July 2010 and ZPR did not retain a new verifier until November or December 2010.⁴¹ Moreover, Ashland had not performed an audit.⁴²

Thus, the evidence clearly showed the Morningstar Reports of September 2010 and March 2011 contained misrepresentations and this element is met.

III. THE RESPONDENTS' ARGUMENTS THAT THEY LACKED SCIENTER ARE UNAVAILING

The Respondents' arguments ignore the overwhelming evidence of scienter, which can be satisfied by a showing of severe recklessness.⁴³ The undisputed evidence showed ZPR, through Zavanelli and its principals, acted with scienter. Each of the Respondents' arguments concerning scienter is without merit. The evidence demonstrated that the Respondents engaged in conscious misstatements concerning GIPS compliance to facilitate their financial need to obtain new investors necessary to keep ZPR in business. The Respondents simply omitted any negative information from their advertisements or made false statements to conceal them, including the pending Commission investigation.

⁴⁰ DX 36

⁴¹ DX 89 at 161:21-23.

⁴² DX 77

⁴³ *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981). Scienter is required for a violation of Section 206(1), but not for Sections 206(2) and 206(4), or Rule 206(4)-1(a)(5) of the Act. *Id.*

**A. THE RESPONDENTS' ARGUMENTS CONCERNING THE 2008 AND 2011
MAGAZINE ADVERTISEMENTS ARE BELIED BY THE EVIDENCE**

First, the Respondents argue the evidence “showed the initial advertisements were created by and submitted to Ashland.”⁴⁴ However, the undisputed evidence was that Ashland created an early magazine advertisement template for ZPR and in 2008, after ZPR experienced negative trading losses, ZPR changed the format of its advertisements to omit the period-to-date performance returns GIPS required because this information would have shown ZPR’s negative performance returns.⁴⁵

ZPR sent Ashland *one* magazine advertisement dated January 2008 and stopped submitting advertisements to Ashland after that because Ashland told them the advertisement did not comply with GIPS.⁴⁶ ZPR then lied to Ashland and told them they were no longer advertising in magazines⁴⁷ when the opposite was true – ZPR was in truth continuing to publish advertisements in magazines with the same compliance deficiencies Ashland had identified while withholding them from Ashland so ZPR could obtain bogus GIPS compliance verifications from Ashland and use those to lure the investors ZPR desperately needed.⁴⁸ Thus, Ashland never reviewed the advertisements at issue, which commenced in October 2008.⁴⁹ Further, this evidence demonstrates ZPR published the non-compliant advertisements beginning in October 2008 and continuing

⁴⁴ Respondents’ post hearing brief at 45.

⁴⁵ Tr. 187:19-189:22.

⁴⁶ DX 19 at page 3; Tr. 959:25-961:11.

⁴⁷ Tr. 933:23-935:2.

⁴⁸ Tr 419:14-21; 420:6-11 and 935:12-16; DX 21.

⁴⁹ Tr. 935:12-16 (Feliz testifying she saw the advertisements for the first time when the Division showed them to her during her investigative testimony in 2011).

through May 2011, knowing they failed to comply with GIPS for the same reasons Ashland had previously told them.⁵⁰

Second, the Respondents argue they stopped advertising in 2009 after the Commission raised issues concerning their advertisements in order to make sure they were in compliance. The evidence shows this is false. ZPR's Board of Directors minutes of April 30, 2009 sets for the true reason why ZPR stopped advertising – finances. Those minutes state, “[t]he company paid large amounts for advertising in 2008, but will not be able to do this in 2009.”⁵¹ The February 11, 2010 Board of Directors minutes state advertising would end because the firm had not seen good results from its advertising. Specifically, they state, “the company paid almost \$97,000 for advertising in 2009, but it has not seen good results from this. The ad campaign will not be extended past the first quarter of 2010.”⁵² The Law Judge should reject the Respondents' transparent efforts to now rewrite history.

Third, the Respondents argue Zavanelli was “shocked” to see the 2008 advertisements during the 2009 Commission examination because he had never bothered to look at them before.⁵³ He blames the noncompliant advertisements on Bauchle. First Zavanelli threatened Bauchle after reading Bauchle's investigative testimony, which was consistent with his testimony at the Final Hearing that Zavanelli knew the advertisements were non-compliant.⁵⁴ He then claimed Bauchle

⁵⁰ Tr. 944:18-950:25; 95219-978:4.

⁵¹ DX 79 at ¶ 6.

⁵² DX 80 at ¶ 8.

⁵³ Post hearing brief at 46.

⁵⁴ DX 102; Tr. 432:14-433:9..

“betrayed” him⁵⁵ and terminated his employment at ZPR.⁵⁶ And now Zavanelli blames Bauchle for the noncompliant advertisements. The Law Judge should find the testimony of Zavanelli, a Commission recidivist with a pattern of withholding evidence from the Commission, not credible and should infer an adverse inference that had the Respondents produced the portal messages, they would have been adverse to their defenses, including Zavanelli’s role in creating and approving the advertisements.

As fully briefed in the Division’s post hearing brief, Zavanelli has demonstrated no respect for the truth in this matter since the Commission’s examination commenced in 2009. He withheld portal documents from what he referred to as “the SEC monster,” obstructed the examination and investigation, lied under oath during his investigative testimony to keep the portal documents a secret,⁵⁷ and then purportedly lost the documents. He should not be able to now argue his lack of involvement in the creation and approval of the advertisements because the documents relevant to this issue are those Zavanelli withheld and then lost.⁵⁸

The evidence presented during the Final Hearing demonstrates scienter.

- Zavanelli testified that he approved all advertisements for publication⁵⁹ and was responsible for ensuring that all of ZPR’s marketing materials were GIPS-compliant.⁶⁰

⁵⁵ DX 123.

⁵⁶ Tr. 139:21-141:2; 142:22-143:2; 413:18-415:4; DX 102.

⁵⁷ DX 89 at 9-11.

⁵⁸ The portal was the primary method of communication and ZPR’s operations were run through the portal. Tr. 151:11-17. As set forth more fully in the Division’s post trial brief, the Commission specifically requested all communications for the relevant time period and ZPR, at Zavanelli’s direction, withheld them.

⁵⁹ Tr. 186:24-187:16; DX 89 at 57:9-14.

⁶⁰ DX 89 at 46:18-47:2.

- Consistent with this, Bauchle testified that Zavanelli controlled what went into the advertisements and made the final decisions concerning the advertisements.⁶¹
- Bauchle also testified that he ZPR Chief Compliance Officer Ruth Ann Fay also believed the advertisements were not GIPS compliant because they failed to disclose the annualized performance returns as GIPS requires.⁶²
- Bauchle told Zavanelli in about September 2008 that the advertisements needed to disclose the performance returns as GIPS requires.
- However, the advertisements were published without this information because Zavanelli made the decision to do so.⁶³
- Indeed, Cabot testified that during her interview of Fay and Bauchle during the examination in 2009, both Fay and Bauchle told her they knew the 2008 advertisements did not comply with GIPS, but Zavanelli made the decision to publish the advertisements anyway.⁶⁴
- In 2008, Ashland told ZPR precisely why its advertisement failed to comply with GIPS and how to correct it, but ZPR ignored this advice, ran the advertisement with the same deficiencies at least 12 more times over the course of more than two years, and lied to Ashland to conceal the advertisements from its GIPS verification process by falsely representing ZPR was not advertising in magazines.
- Zavanelli was aware of the GIPS advertising rules at all times relevant to the conduct at issue because he read GIPS and considered himself the closest thing to an expert there was at ZPR.⁶⁵ He understood that claiming GIPS compliance meant ZPR met all the GIPS standards.⁶⁶
- Zavanelli, who testified he approved all advertisements and GIPS compliance claims, only began omitting the performance returns GIPS requires in October 2008, after ZPR suffered tremendous trading losses GIPS would have required it to reveal.

⁶¹ Tr. 186:24-187:16; 205:4-10.

⁶² Tr. 193:1-18. Fay, who is Zavanelli's ex-wife, now claims she never had this discussion. However, Fay also concealed the portal documents from the Commission by stating the portal lacked ZPR's books and records despite admitting at the Final Hearing this was false. *See* DX 41.

⁶³ Tr. 205:4-10.

⁶⁴ *Id.*

⁶⁵ DX 89 at 42:9-22

⁶⁶ DX 89 at 45:6-21.

- Zavanelli admitted that had ZPR disclosed the performance returns GIPS required, it would have shown negative performance returns instead of the positive ones he advertised.
- In February 2009, the Commission notified ZPR of that its 2008 magazine advertisement did not comply with the GIPS Advertising Guidelines.
- Specifically, on February 13, 2009, Cabot, the lead Commission examiner, met with Bauchle and Fay to advise them of deficiencies the Commission found concerning ZPR's advertisements.⁶⁷
- Among other things, Cabot told them the December 2008 advertisement failed to comply with the GIPS requirements to disclose period-to-date and annualized returns as GIPS required.⁶⁸ Cabot also indicated the advertisements falsely stated Ashland audited ZPR's returns.⁶⁹
- The Commission memorialized these and other findings in a deficiency letter to ZPR dated January 2010.⁷⁰
- ZPR responded by telling the Commission it would take corrective action. In a letter dated February 2010, ZPR told the Commission, it would stop claiming it was audited and "changed our ads to show the 1, 3, 5-year annualized returns in US dollars and will revise our footnotes."⁷¹
- ZPR failed to take these corrective actions.
- Instead, two months later, they marketed that Ashland had audited them,⁷² and five months after that, they repeated the same false statement.⁷³
- Similarly, ZPR continued to it published the February 2011, March 2011, and April 2011 magazine articles containing the same GIPS violations.⁷⁴

⁶⁷ DX 77; Tr. 431:2-432:5, 486:2-488:20.

⁶⁸ *Id.* This was not the first time ZPR was told its claim that Ashland audited them was false. In early 2009, Ashland also raised this issue with ZPR and advised the firm it should stop saying Ashland audited ZPR because this was not accurate. Tr 239:6-16. In addition, in October 2009, Ashland notified ZPR in writing that its verification was not an audit. DX 19.

⁶⁹ *Id.*

⁷⁰ DX 77.

⁷¹ DX 78.

⁷² DX 22 at page 2 and 367; Tr. 242:22-244:13, 246:14-19.

⁷³ DX

- Zavaneli admitted he approved them.⁷⁵
- Respondents argue the 2011 advertisements included the GIPS compliance claim while not complying with GIPS because they were reprints.⁷⁶
- However, this excuse also proved to be false. Zavaneli admitted he made *seventeen* changes to the original advertisements before he reprinted them.⁷⁷ He admitted that one of the changes he made was to add the statement that ZPR was GIPS-compliant.⁷⁸
- Zavaneli also admitted that of all the changes he made to the advertisements before reprinting them, none of these changes included adding the information the GIPS advertising guidelines require.⁷⁹
- Thus, Zavaneli simply chose to add the claim of GIPS compliance while once again ignoring the GIPS advertising rules altogether – after reading GIPS,⁸⁰ after gaining enough knowledge to consider himself the closest thing there was to an expert on it at ZPR,⁸¹ after Ashland had advised ZPR of the GIPS Advertising Requirements at least five times,⁸² after Bauchle advised him advertisements were not GIPS compliant for failure to correctly present performance returns,⁸³ after the Commission advised him of the same noncompliance issues in a Deficiency Letter,⁸⁴ and after Ashland terminated him a investor for his failure to comply with GIPS.⁸⁵

⁷⁴ RX 15, 17, 19.

⁷⁵ DX 89 at 67:3-10; 69:1-6; 72:16-20; DX 65-67.

⁷⁶ Tr. 116:10-15; RX 15, 17, 19.

⁷⁷ Tr. 1162:6-1664:3.

⁷⁸ Tr. 1665:1-1668:22.

⁷⁹ *Id.*

⁸⁰ DX 89 at 42:9-22

⁸¹ DX 89 at 42:9-22

⁸² Tr. 954:20-956:4; DX 47 at 0074; DX 64 at 4; DX 47 at 0074; DX 84 at 00005; DX 51; DX 52.

⁸³ Tr. 193:1-18; 487:5-491:15.

⁸⁴ DX 77-78.

⁸⁵ DX 36

This pattern of conduct is more than enough to establish scienter. The Court should reject the Respondents' arguments that they lacked scienter concerning the 2008 and 2011 magazine advertisements and find that this element satisfied.

B. THE RESPONDENTS' ARGUMENT CONCERNING THE NEWSLETTERS IS BELIED BY THE EVIDENCE

The Respondents argue they lacked scienter concerning the newsletters because Zavanelli believed that after Ashland repeatedly told him that the newsletters did not comply with GIPS, Ashland was silent and so Zavanelli assumed he could continue publishing the newsletters.⁸⁶ This convoluted argument – unsupported by *any* evidence other than Zavanelli's own testimony – ignores the credible evidence in this matter. Even if he reasonably ignored his GIPS verifier's advice (and he did not), Zavanelli admitted he read GIPS prior to publishing the 2009 newsletters.⁸⁷ GIPS sets forth the definition of "advertisements" under GIPS and includes a one-page list of items that firms claiming GIPS compliance must include in their advertisements.⁸⁸ Zavanelli read this and chose to ignore it. GIPS defines an advertisement as follows:

any materials that are distributed to or designed for use in newspapers, magazines, firm brochures, letters, media, or any other written or electronic material addressed to more than one prospective investor. *Any written materials (other than one-on-one presentations and individual investor reporting) distributed to maintain existing investors or solicit new investors for an advisor is considered an advertisement.*⁸⁹

The newsletters are from Zavanelli to investors⁹⁰ and their content makes clear that he distributed them to maintain his existing investors. For example, the newsletters tell investors to

⁸⁶ Respondents' post hearing reply brief at 46.

⁸⁷ DX 89 at 42:9-22

⁸⁸ DX 25.

⁸⁹ DX 25 at 33 ("Definition of Advertisement") (emphasis added).

⁹⁰ DX 10 & 11.

“wait,” “hold on,” reassure investors about recent trading losses, and tout other composites Zavanelli is offering for trade through ZPR. Thus, having read the definition of “advertisements,” Zavanelli knew or should have known the newsletters were advertisements. Indeed, Mark Zavanelli easily figured this out shortly after becoming president of ZPR.⁹¹

And to the extent the plain language of GIPS was not clear enough, both ZPR’s verifier and the Commission told ZPR the newsletters were advertisements requiring GIPS compliance *before* Zavanelli distributed the newsletters at issue. Zavanelli simply chose not to follow the language of GIPS, his GIPS verifier’s advice, or the Commission’s findings. Instead, he *chose* to continue distributing misleading newsletters that claimed GIPS compliance without complying with the GIPS advertising requirements.

The undisputed evidence showed as follows:

- The 2005 version of GIPS at issue clearly and in plain language sets forth in a one-page summary the requirements for advertisements when a firm claims GIPS compliance.⁹²
- Zavanelli admitted he read this version of GIPS and claimed to be the closest thing to an expert there was.⁹³
- Yet he ignored the plain language of GIPS, the advice of his own GIPS verifier, and the findings of the Commission and instead continued distributing non-compliant newsletters, including those in April and December 2009.
- Feliz told Zavanelli the newsletters were advertisements, and that since he claimed in the newsletters that ZPR was GIPS-compliant, he was required to comply with the GIPS advertising guidelines or include a GIPS-compliant presentation with the newsletter.⁹⁴
- In November 2008, Ashland emailed ZPR with instructions about how to correct the newsletters so they complied with GIPS.⁹⁵

⁹¹ DX 133

⁹² DX 25 at p.34.

⁹³ DX 89 at 42:9-22

⁹⁴ Tr. 956:11-957:5. Since ZPR published the newsletter on its website, Feliz advised ZPR it must make its website GIPS-compliant. DX 84; Tr. 201:16-203:14. However, Zavanelli told Feliz he did not want to include the compliant presentation on the website to make it comply with GIPS because this would have revealed the small number of assets ZPR had under management. Tr. 957:6-24.

⁹⁵ DX 47

- Specifically, Ashland advised ZPR to either: (1) amend the newsletters to include all of the information the GIPS advertising guidelines require, including 1-, 3-, and 5-year returns or performance returns for each of the most recent five years; or (2) attach a GIPS-compliant presentation.⁹⁶
- Bauchle then Ashland's advice and attached the GIPS-compliant presentation in late 2008.⁹⁷
- Bauchle did not consult Zavanelli before attaching the presentation to the newsletter because based on his prior conversations with Zavanelli, Bauchle knew Zavanelli would disagree.⁹⁸ Zavanelli had stated he did not want potential investors to view the GIPS-compliant presentation because it showed a small number of assets under management.⁹⁹
- In or after late 2008, when Zavanelli subsequently learned Bauchle had taken Ashland's advice and attached the presentation to the newsletter, he got upset because he did not want others to know the small amount of assets under management.¹⁰⁰
- Therefore, at Zavanelli's direction, ZPR never again attached the presentation to the newsletter.¹⁰¹
- Zavanelli explained to Feliz he did not want to include the compliant presentation because it showed a small number of assets under management.¹⁰² Feliz told Zavanelli he needed to amend the newsletter so it complied with the GIPS advertising guidelines by including the information those guidelines require.¹⁰³
- Ignoring Ashland's advice, ZPR continued to distribute newsletters to investors and potential investors on its website that omitted the performance returns GIPS requires. This included the April and December 2009 newsletters.

⁹⁶ DX 47

⁹⁷ DX 47; Tr. 206:18-207:2.

⁹⁸ Tr. 207:3-20

⁹⁹ *Id.*

¹⁰⁰ Tr. 207:3-208:15

¹⁰¹ *Id.*

¹⁰² Tr. 957:6-24.

¹⁰³ *Id.*

- Not only did Zavanelli refuse to make the advertisements GIPS compliant based on Ashland's advice, he also ignored the Commission's same advice in February 2009 – before the April and December 2009 newsletters at issue.
- In February 2009, the Commission advised Bauchle and Fay, who in turn advised Zavanelli, the newsletters had to include the annual performance returns in its advertisements.¹⁰⁴
- Two months later, Zavanelli published the April and December 2009 newsletters claiming compliance with the GIPS standards while omitting the (i) period-to-date returns and (ii) 1-, 3-, and 5-year returns or the most recent five years of performance returns GIPS required.¹⁰⁵
- As discussed in above in Section IV, ZPR's performance returns for the year 2008 were negative and showed ZPR underperforming the market. Thus, had ZPR disclosed the one-year returns in the 2009 advertisements, as GIPS required, it would have revealed ZPR's negative performance returns and underperformance of the index for the one-year period of 2008. Therefore, Zavanelli chose to omit this information from his newsletters.
- Zavanelli also failed to attach the GIPS-compliant presentation to the newsletters, despite knowing this was required if he did not provide the performance return information in the newsletters.¹⁰⁶ Had ZPR attached the GIPS-compliant presentation, the newsletters would have revealed ZPR had a relatively small amount of assets under management. This was precisely the information Zavanelli wanted to conceal from investors and potential investors.¹⁰⁷ Therefore, he chose to omit it while still claiming GIPS compliance.
- As a result of ZPR's repeated failure to comply with GIPS in its newsletters, Ashland terminated ZPR as a investor in June 2010.¹⁰⁸ Feliz testified that she has worked for 400 or more investors as a GIPS verifier and has terminated one – ZPR.¹⁰⁹

¹⁰⁴ DX 77; Tr. 431:2-432:5, 486:2-488:20.

¹⁰⁵ *Id.*

¹⁰⁶ Tr. 207:3-20.

¹⁰⁷ Tr. 207:3-20

¹⁰⁸ DX 36

¹⁰⁹ Tr 1006:19-1007:4

This pattern of conduct more than satisfies the scienter element. Respondents' brief ignores all of these facts and argues simply that Zavanelli did not receive the November 2008 letter from Ashland. Based on the evidence set forth above and Zavanelli's lack of credibility, the Court should reject this defense and find the Respondents acted with scienter.

**C. THE RESPONDENTS' SCIENTER ARGUMENT CONCERNING THE
FALSE MORNINGSTAR REPORTS IS WRONG**

The Respondents argue they lack scienter by once again blaming Bauchle, whom they claim provided the false information to Morningstar without Zavanelli's knowledge. This is wrong for at least two reasons.

First, the Respondents' argument that Zavanelli was not involved in the creation of the Morningstar reports is based solely on the uncorroborated testimony of Zavanelli who, as set forth above and in the Division's post hearing brief, lied throughout the examination and investigation in this case and is not credible. The Morningstar Report includes a box where the firm may check "yes" or "no" to the question of whether there is a "pending Commission investigation."¹¹⁰ There are no communications concerning the Morningstar Report because the Respondents withheld and then lost all portal correspondence for this time period. As set forth in the Division's Post-Hearing Brief, the Law Judge should infer an adverse inference that Zavanelli was involved in the creation of the Reports, or find ZPR had scienter based on the conduct of Bauchle.

Supporting the adverse inference is the undisputed evidence that after Mark Zavanelli replaced Max Zavanelli, Bauchle took direction from Mark Zavanelli and Mark Zavanelli told him how to answer the questions in the Morningstar Reports, including reporting that there was no

¹¹⁰ DX 10 & 11.

Commission investigation pending.¹¹¹ Despite being aware of the pending investigation and even retaining counsel in it, Mark Zavanelli told Bauchle in 2012 to check the “no” box.¹¹² While we have Mark Zavanelli’s communications to Bauchle concerning the 2012 Report, we lack the communications concerning the 2010 and 2011 Reports because Zavanelli withheld these portal documents and then purportedly lost them. The Law Judge should infer an adverse inference that Max Zavanelli instructed Bauchle how to complete the Report, just as Mark Zavanelli did after him, and that had the Respondents produced the portal it would have been adverse to their position..

Second, even if he had no involvement in creating them, Zavanelli saw the Morningstar Reports,¹¹³ was responsible for all advertisements, knew about the investigation by August 16, 2010,¹¹⁴ and made no effort to correct the Morningstar Reports¹¹⁵ or ensure the false statements in the September 2010 Report were not repeated – which they were.¹¹⁶ He was, at best, recklessly indifferent, and ZPR repeated the same misrepresentation in the April 2011 Report. The investigation was active during the time between the two reports, and Zavanelli and Bauchle were aware of that fact.

For example, before or shortly after ZPR created the September 2010 Report (created in about October 2010) and before ZPR created the March 2011 Report (created in about April 2011),

¹¹¹ DX 132.

¹¹² DX 132.

¹¹³ DX 157.

¹¹⁴ 773:13-16, DX 92.

¹¹⁵ Tr. 259:9-260:20.

¹¹⁶ DX 11.

the Commission took Bauchle's testimony¹¹⁷ and advised him it was in connection with a Commission investigation,¹¹⁸ ZPR received two additional letters concerning the investigation,¹¹⁹ and ZPR retained counsel in the investigation.¹²⁰ Zavanelli admitted was aware of the investigation by August 16, 2010¹²¹ and Bauchle by October 14, 2010.¹²² Yet in April 2011, ZPR created another Morningstar Report falsely stating there was no "pending Commission investigation."¹²³ This conduct reflects a high level of scienter, and the Respondents' claim that they did not know an investigation was pending is belied by the evidence set forth above and Zavanelli's own admission at the Final Hearing.¹²⁴ The Respondents' argument that they believed there was no investigation until the Commission filed an OIP is similarly unavailing. The Morningstar Reports clearly have a separate inquiry for "pending Commission litigation" that is distinct from the inquiry at issue concerning a pending Commission investigation.¹²⁵ Finally, the Morningstar Reports reflect that ZPR chose not to answer certain inquires on the form and left boxes unchecked.¹²⁶ ZPR chose not to use that option when preparing the Reports at issue and instead chose to make affirmative misrepresentation by checking the "no" box and falsely telling

¹¹⁷ Tr 773:17-25

¹¹⁸ Tr. 437:24-438:4

¹¹⁹ DX 92 at pp. 5 and 13.

¹²⁰ DX 92 at p.13

¹²¹ 773:13-16

¹²² Tr 437:18-438:4.

¹²³ DX 11; Tr. 255:3-13

¹²⁴ 773:13-16

¹²⁵ DX 10 and 11.

¹²⁶ *Id.*

potential investors there was no investigation when Bauchle and Zavanelli knew one was pending. Either Zavanelli directed the Report or Bauchle had authority to speak on behalf of ZPR in creating the Report. Either way, they were both aware of the pending investigation as of the dates set forth above, and their recklessness can be imputed to ZPR.

IV. THE RESPONDENTS' ARGUMENTS CONCERNING MATERIALITY REFLECT A MISUNDERSTANDING OF THE EVIDENCE AND LAW

A. THE MAGAZINE ADVERTISEMENTS AND NEWSLETTERS

The Respondents argue the misrepresentations and omissions in the magazine advertisements and newsletters are not material because ZPR made the omitted performance return information available through other sources.¹²⁷ Their argument fails to address the materiality of the false claim that ZPR was GIPS compliant. GIPS is an ethical set of standards.¹²⁸ As Zavanelli admitted, GIPS compliance is important to institutional investors.¹²⁹ In deciding whether to retain an advisory firm's services, institutional investors consider whether an investment adviser is GIPS-compliant. The undisputed evidence showed that GIPS compliance is necessary to attract institutional investors, and ZPR began claiming GIPS compliance to lure them.¹³⁰

Zavanelli and Bauchle understood that when institutions are looking for an advisor to manage their money, one of the screens they use is to check whether the investment adviser firm is GIPS-compliant and, if they are not GIPS-compliant, the institutional investors do not consider

¹²⁷ Respondents' post hearing brief at 48,

¹²⁸ Tr. 922:13-923:7.

¹²⁹ Tr. 827:23-828:1.

¹³⁰ Tr. 184:10-185:16.

them.¹³¹ In late 2005, ZPR began speaking with an institutional consultant called Greg Reed and Associates that helps institutions find investment advisers to manage their money.¹³² Greg Reed recommended to ZPR that it would be beneficial if the firm obtained GIPS verification and was able to produce performance numbers that adhered to the GIPS policies and procedures.¹³³ ZPR understood from Greg Reed that if it claimed GIPS compliance for a period of years, it would be able to effectively compete for institutional investors.¹³⁴ Therefore, in 2006, ZPR retained Ashland Partners, a company that verifies investment adviser firms are complying with GIPS,¹³⁵ and began claiming GIPS compliance in 2007.¹³⁶

Zavanelli admitted each of the advertisements claimed GIPS compliance, and each of the advertisements failed to comply with GIPS. Clearly, institutional investors would have wanted to know that ZPR was not in truth complying with GIPS and was not making the full and fair disclosures of performance returns in its advertisements that GIPS was established to ensure.

B. THE MORNINGSTAR REPORTS

The Respondents' argument that the false statements in the Morningstar Reports are not material because they were not required to disclose the investigation in their Form ADV until a Wells Letter issued defies reason. In the Morningstar Reports, ZPR chose to make an affirmative statement that there was no pending SEC investigation. This was false. End of story. Clearly, any

¹³¹ Tr.185:12-186:2.

¹³² Tr. 184:10-185:11.

¹³³ Tr. 184:10-22.

¹³⁴ Tr. 185:12-16.

¹³⁵ TR 186:3-10, 902:2-14. 906:17-19.

¹³⁶ Tr. 621:15-17.

potential investor would have wanted to know that in truth ZPR was the subject of a pending Commission investigation before deciding to invest through ZPR.

V. THE RESPONDENTS' ARGUMENT THAT THEY DID NOT ACT WILLFULLY IGNORES THE EVIDENCE

“Willfully” in the context of Commission enforcement actions means “intentionally committing the act which constitutes the violation.”¹³⁷ This does not require a finding that ZPR had knowledge of the rule or regulation violated.¹³⁸

The Respondents’ argument that their conduct was the result of ignorance or mistake rather than willfulness ignores the evidence in this matter. The evidence showed the Respondents acted willfully to advertise in whatever way was necessary to lure investors, with disregard for the truth and GIPS, because ZPR was in dire financial straits and needed new investors in order to continue. The evidence showed the following:

In 2008, ZPR’s business took a turn for the worse. In 2008, ZPR realized income of less than \$7,000.¹³⁹ In March 2008, ZPR suffered its worst performance returns.¹⁴⁰ Zavanelli admitted advertising the period-to-date returns would have revealed the poor performance.¹⁴¹ Therefore ZPR changed the format of its advertisements to exclude this information that was previously included in the advertisements.¹⁴²

¹³⁷ *Wonsover v. Commission*, 205 F.3d 408, 414 (D.C. Cir. 2000).

¹³⁸ *Id.*

¹³⁹ DX 79 at paragraph 4

¹⁴⁰ DX ; Tr.

¹⁴¹ DX 89 at 142:6-24.

¹⁴² Tr. 188:15-189:5.

Beginning with its next advertisement, which was in October 2008 (the first advertisement at issue in this matter), ZPR excluded the period-to-date performance returns and the returns for each year as GIPS requires.¹⁴³ ZPR advertised only its favorable historic performance returns.¹⁴⁴ Zavanelli admitted this new version of the advertisements did not comply with GIPS.¹⁴⁵

From 2006 until October 2008, ZPR included period-to-date returns in its advertisements.¹⁴⁶ Bauchle explained why ZPR changed its advertisements beginning with the October 2008 *Smart Money* Magazine advertisement to exclude this information:¹⁴⁷

Q Does ZPR run magazine advertisements?

A Yes.

Q Who created the ads?

A The original ad template for showing each year listed by itself, Ashland had helped us with that.

Q You said the original ad listed each year by itself?

A Yes.

¹⁴³ *Id.*; DX 21 at 00005; DX 89 at 139:8-140:1.

¹⁴⁴ Tr. 187:6-189:18; DX 21 at 0005 (October 2008 Advertisement).

¹⁴⁵ DX 89 at 139:8-140:1.

¹⁴⁶ Tr. 187:17-188:25.

¹⁴⁷ Tr. 187:17-189:22.

Q When did ZPR utilize those ads?

A That would have been probably in late 2006, we started running those.

Q And when you say they listed each year, can you describe what those ads were?

A The advertisement would list each year's return separately, so 2001 return for the composite and then the comparable index was shown, 2002, 2003, 2004, 2005.

Q And did those returns also include the period to date return information that GIPS requires?

A The ad would have included the period to date depending on when the ad was run.

Q At some point, did ZPR decide to change the format of its ads?

A Yes.

Q When?

A In October of 2008.

Q Why?

A Well, the returns in the start of 2008, the general market was doing bad and so were we and showing the period to date returns for 2008, it would have been a bad comparison. It would not look good.

Q So what, did ZPR just not include that information in the ads?

A An advertisement was ran with a 10-year annualized return and the 10-year compounded return also being shown.

Q Could you turn to your binder that's volume 1?

A Okay.

Q Volume 1 of the Division's exhibits, if you would please turn to Division Exhibit 21.

A I'm looking at it.

Q Would you turn in that packet that you're looking at of the ads to the October 2008 Smart Money advertisement?

A I'm looking at it.

Q Is this the ad you were referencing when you said the format of the ads changed?

A Yes, ma'am.

Q And had ZPR published the period-to-date return information in this ad, what would it have shown?

A We would have been down.

Thus, ZPR willfully changed its advertisements to omit the period-to-date returns GIPS requires because it would have looked bad to potential investors. ZPR continued omitting this information while claiming GIPS compliance through at least May 2011.¹⁴⁸ ZPR was having

¹⁴⁸ DX 21, RX 15, 17, 19.

serious financial problems beginning in 2008,¹⁴⁹ in June and December 2009,¹⁵⁰ Zavanelli was loaning the firm money to keep it afloat,¹⁵¹ and Zavanelli and ZPR knew that a claim of GIPS compliance was necessary to lure the institutional investors the firm so desperately needed. And so with full knowledge of the GIPS requirements, the Respondents ran advertisements ignoring those requirements while simultaneously making a hollow claim of GIPS compliance that was necessary to lure investors.

For the same reasons, the Respondents willfully and affirmatively stated in their Morningstar Reports that there was no Commission investigation pending, even though they were actively engaged in the investigation at that time. As with the magazine and newsletter advertisements, the Respondents simply advertised the positive and concealed or lied about the negative information concerning ZPR in order to lure new investors.

VI. THE RESPONDENTS' ARGUMENTS AGAINST SANCTIONS ARE UNPERSUASIVE

A. THE PERMANENT BAR

Zavanelli's arguments against an institutional bar ignore the Respondents' egregious conduct and the circumstances of the violative conduct. The undisputed evidence showed the Respondents willfully lied in their advertisements to tout their false GIPS compliance, which they understood was necessary for luring institutional investors, while concealing the information GIPS required in those same advertisements. Bauchle explained why in October 2008 the Respondents began omitting the GIPS-required information – it would have shown negative performance

¹⁴⁹ DX 79.

¹⁵⁰ Tr. 1215:22-1219:25.

¹⁵¹ DX 82, 83.

returns and “it would not look good.”¹⁵² And so the Zavanelli, experiencing financial problems and in need of new investors, said whatever was necessary to lure those investors without any regard for the truth. He did this despite reading GIPS and knowing its requirements. He did this despite considering himself the closest thing to a GIPS expert there was at ZPR. He did this despite Ashland telling him the GIPS requirements. And he continued doing this even after Ashland resigned over concerns about ZPR’s GIPS compliance and even after the Commission sent him a Deficiency Letter addressing the GIPS deficiencies.

Zavanelli has shown no regard for the truth, both in his advertisements and in this matter. He has shown he will say whatever it takes, in reckless disregard for the truth, including allowing ZPR to falsely state there is no pending Commission investigation while actively engaged in one. Just as he hid evidence from the Commission, so too will he continue to obstruct the truth in the industry.

Zavanelli’s argument that the conduct was recurrent is also wrong. He claims that until ZPR experienced poor performance returns, the firm disclosed them. Basically, he argues that from 1987 until 2007, he did not lie or conceal the truth. However, the evidence demonstrated that from October 2008, when ZPR changed its advertisements to omit the negative period-to-date performance returns because “it would not look good,” until at least May 2011, he approved advertisements and sat at the helm of ZPR while it published false advertisements on at least ten occasions. This conduct, which spanned years and was not an isolated event, shows the recurrent nature of the violative conduct.

¹⁵² Tr. 187:17-189:22.

Zavanelli's argument that he lacked scienter for a bar because absent the false claim of GIPS compliance, the advertisements were true ignores the evidence concerning the false Morningstar Reports. It also ignores the realities of this case. The issue here is that Zavanelli lied about GIPS compliance because he knew GIPS compliance was necessary for luring investors. He used the false claims for a purpose – to lure the investors ZPR needed. And he omitted from these same advertisements the information GIPS requires because that information “would not look good” to potential investors. The evidence shows he engaged in the conduct to deceive potential investors and said whatever he needed to in order to make that happen.

Zavanelli's assurances against future violations ring hollow and are only addressed to his role at ZPR. He argues there is no likelihood of future violations by ZPR or Zavanelli because Mark Zavanelli is now at the helm. This ignores the evidence which showed Zavanelli is still actively engaged in ZPR and directing Mark Zavanelli's conduct.¹⁵³ Further, this provides no assurance against future violations by Zavanelli outside of ZPR.

Additionally, having Mark Zavanelli at the helm gives little assurance against ZPR's future violations. After Mark Zavanelli became president, he directed Bauchle to state in the Morningstar report that there was no pending Commission investigation.¹⁵⁴ When Mark Zavanelli directed Bauchle to provide this false information, he knew there was a Commission investigation because he had read the investigative testimony stating there was an investigation and was paying lawyers to defend ZPR in the investigation.¹⁵⁵ When confronted with these facts and his failure to take any

¹⁵³ Tr. 758:14-23; 761:2-7; DX 98, 117.

¹⁵⁴ DX 132.

¹⁵⁵ Tr. 1299:2-1310:20; DX 132; Tr. 131:11-1314:8; 1322:1-1323:13; 1325:18-1328:21; DX 89 at 6:1; Tr. 437:24-438:4.

corrective action after becoming president of ZPR, Mark Zavanelli claimed he did not know there was a Commission investigation.¹⁵⁶ This denial is belied by the evidence. Mark Zavanelli is an Ivy-league educated businessman with a 15-year career in the securities industry who not only admitted to reading the investigative testimony transcripts stating there was an investigation but also admitted to paying lawyers to defend ZPR in the investigation.¹⁵⁷ His testimony was not credible. Further, he was reckless in telling Bauchle to create Morningstar Reports stating there was no pending Commission investigation because, as set forth above, Mark Zavanelli knew an investigation was indeed pending.

Moreover, Mark Zavanelli also admitted that after he became president of ZPR in 2011, he reviewed the GIPS issues and the deficiency letter of January 2010, but took no corrective action until after the Commission instituted the OIP in 2013.¹⁵⁸ On top of that, Mark Zavanelli knew ZPR concealed the portal communications from the Commission because Fay told him in September 2011.¹⁵⁹ Specifically, on September 9, 2011, Fay wrote to Mark Zavanelli, advised him ZPR produced no portal messages in response to the Commission's request for electronic communications, and stated, "I wonder if they had the talent to hack it."¹⁶⁰ The investigation continued for more than another year with Mark Zavanelli at the helm of ZPR as president, and at no time did he mention the portal or take any action to correct or supplement the prior productions. Instead, he continued to conceal them.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ Tr. 1322:1-1323:13.

¹⁵⁹ DX 130.

¹⁶⁰ *Id.*

As for the Respondents' recognition of wrongful conduct, their Post-Hearing Brief reflects why relief is necessary. Even now, they claim they are still trying to figure out what they did wrong.¹⁶¹ They do not recognize that distributing false and misleading advertisements is wrong, and this further supports imposing the relief sought against them.

B. A CEASE-AND-DESIST ORDER

The Respondents' claim a cease-and-desist order is not appropriate because they now have two consultants¹⁶² retained to review advertisements and Mark Zavanelli will also review them. This only shows that little has changed since the time ZPR engaged in the violative conduct. When the violative conduct occurred, ZPR had a GIPS verifier. That did not stop the Respondents from engaging in the conduct at issue, and there is no reason to believe that having two consultants instead of one will make any difference for this particular firm based on their prior history of violating the law behind their verifier's backs. As for Mark Zavanelli's leadership providing any assurances, this is fully addressed in the immediately preceding section of this brief.

In *Valicenti Advisory Services, Inc.*, Investment Advisers Act. Rel. No. 1774 (Nov. 18, 1998), *aff'd.*, *Valicenti Advisory Services v. SEC*, 198 F.3d 62 (2d Cir.1999), a case involving violations of the Investment Advisers Act by distributing false and misleading performance advertisements, the respondents argued against a cease-and-desist order on the same basis as what the Respondents in this case do - that no sanctions were warranted because their record in

¹⁶¹ Respondents' Post-Hearing Brief at 51.

¹⁶² Notably, the Respondents did not call either of these consultants to testify in the Final Hearing to explain how and why any procedures are in effect that would give the Law Judge some assurances, or whether or not ZPR has indeed been providing advertisements to the new consultants.

the advisory was otherwise unblemished, the advertisements were isolated occurrences, and no one was harmed. In rejecting these arguments, the Law Judge stated:

We take a less sanguine view of respondents' violations. Investment advisers are fiduciaries whose actions must be governed by the highest standards of conduct. [12] However, respondents chose to ignore those standards, and perpetrated a serious fraud on prospective clients of the firm. Contrary to the claim made by respondents, their actions demonstrate a substantial likelihood of further misconduct on their part.

The Law Judge imposed the same type of relief the Division seeks here. In the instant case, the Law Judge should hold ZPR and Zavanelli to the highest standards of conduct and impose the relief requested.

C. CIVIL PENALTIES

The Respondents' argument that their conduct did not involve fraud or deceit ignores the evidentiary record of this case and the evidence demonstrating that the Respondents knowingly and willfully made false claims of GIPS compliance and made false statements denying the Commission's pending investigation as part of a concerted effort to lure investors.

Their argument that no one was harmed ignores the potential harm to the investing public when Investment Advisers engage in false advertising to lure investors. Further, contrary to the Respondents' assertions, the evidence, in the form of their own internal messages, showed ZPR did obtain new investors as a result of their advertisements.¹⁶³

Zavanelli next argues that there are no prior violations of the laws because the Commission's prior Administrative Proceeding against him was wrong. This reasoning is flawed. Zavanelli admits the Commission previously censured him in connection with false advertisements previously. The Commission entered an Order, and thus he has a regulatory

¹⁶³ DX 150.

history. The Law Judge should consider that history and also that it involved the same type of conduct at issue here – disregard for the truth in advertising. Further, while the Respondents argue the prior case did not involve ZPR, Zavanelli admitted that the company at issue in the prior case *is* ZPR.¹⁶⁴

Finally, the Respondents argue that there is no need to deter them because they have two consultants, rather than just the one they had when the violations occurred, and Mark Zavanelli is now at the helm of ZPR. As set forth above, this gives little assurance against the Respondents' future violations.

For the reasons set forth above and in the Division's Post-Hearing Brief, the Law Judge should enter the relief the Division seeks against the Respondents.

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Respectfully submitted,



Amie Riggle Berlin
Senior Trial Counsel
Direct Line: (305) 982-6322
E-mail: berlina@sec.gov

DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
801 Brickell Avenue, Suite 1800
Miami, FL 33131
Phone: (305) 982-6300
Fax: (305) 536-4154

¹⁶⁴ Tr. 752:11-14; 753:4-8. DX 89 at 12:12-13:3.